

**STATE OF WASHINGTON  
OFFICE OF THE INSURANCE  
COMMISSIONER**



**FINANCIAL EXAMINATION  
of  
HEALTH CARE AUTHORITY  
LACEY, WASHINGTON**

**JUNE 30, 2005**

Order No. G 06-49  
Health Care Authority  
Exhibit A

SALUTATION

Seattle, Washington  
July 25, 2006

The Honorable Mike Kreidler, Commissioner  
Washington State Office of the Insurance Commissioner (OIC)  
Insurance Building – Capital Campus  
302 – 14<sup>th</sup> Ave SW  
Olympia, WA 98504

Dear Commissioner Kreidler:

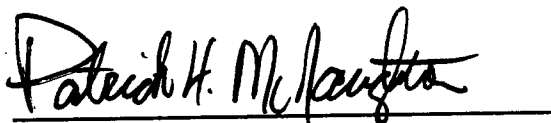
In accordance with your instructions and in compliance with the statutory requirements of RCW 41.05.140(5), and RCW 48.03.010, an examination was made of the corporate affairs and financial records of the

HEALTH CARE AUTHORITY  
of  
Lacey, Washington

hereinafter referred to as “HCA” or “the Authority”, at its office located at 676 Woodland Square Loop SE, Lacey, Washington 98504-2682. The following report of examination is respectfully submitted, showing the condition of the Authority as of June 30, 2005.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the Health Care Authority, Lacey, Washington. This report shows the financial condition and related Authority matters as of June 30, 2005.

A handwritten signature in black ink, reading "Patrick H. McNaughton", written over a horizontal line.

Patrick H. McNaughton  
Chief Examiner

July 25, 2006

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## **SCOPE OF THE EXAMINATION**

This examination covers the period July 1, 2001 through June 30, 2005 and comprises a comprehensive review of the books and records of the Authority. The examination followed the applicable statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH) and Accounting Practices and Procedures Manual (AP&PM). The examination included identification and disposition of material transactions and events that were noted during the examination but which occurred subsequent to the examination date.

Authority records, external reference materials, and various aspects of the HCA's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report.

## **INSTRUCTION**

As part of the statutory examination, the examiners reviewed the Authority's filed financial statements as of June 30, 2005. This review was performed to determine if HCA completed its annual statement in accordance with the relevant OIC instructions and to determine if its accounts and records were prepared and maintained in a manner adequate to facilitate preparation of its required financial reports and statements to the OIC.

The following exception was noted while performing this review.

### **1. Inaccurate Cutoff of Paid Claims**

The paid date for claims recorded by HCA could be a few days different from the actual date on which the checks are paid by the third party claims administrators. If the fiscal year-end differs from the day the weekly payments are made, the payments should be appropriately pro-rated between the fiscal periods. HCA does not make such prorations; it just ensures that 52 weekly payments are included in each year. This can result in cutoff errors and accounting misstatements at the beginning and end of the years, since weekly payments are made on the same day each week and rarely correspond with the actual flow of claims.

For example, the Uniform Medical Plan (UMP) payments failed to coincide with the account cutoff at the beginning and end of the fiscal year ending June 30, 2005. Consequently, \$3,003,125 of net prior year medical claims were paid and booked in the fiscal year ending June 30, 2006. As a result, the fiscal year ended June 30, 2005 "Excess of revenues over expenses" was overstated by \$3,003,125. That excess should have been \$62,844,046, not the reported \$65,847,171.

Because HCA is a governmental entity, whose Fund Balance is overseen by the Executive and Legislative branches of Washington State, no adjustment is recommended

to correct the above error. The Authority is instructed to comply with RCW 48.05.073 which requires financial statements to follow the NAIC AP&PM. In particular, recognition of claim activity should be reported in the period incurred pursuant the NAIC Statement of Statutory Accounting Principles No. 55 which states "Claims, losses, and loss/claim adjustment expenses shall be recognized as expense when a covered or insured event occurs."

**In accordance with RCW 41.05.140(7) and RCW 48.05.073, the Authority is instructed to file its financial statements in accordance with the NAIC accounting practices and procedures. This requires accurate accruals of claim expenses from the date incurred, not paid. It will also enhance comparability with other organizations while facilitating management analysis and decision-making.**

## **AGENCY PROFILE**

### **HCA History**

The Health Care Authority was established by the Washington State Health Care Reform Act of 1988 under RCW 41.05 (the Act). The Act authorizes the Authority to insure any type of loss under its jurisdiction except property and casualty risks. The Washington State Legislature recognized that the state is a major purchaser of health care services and the increasing costs of these services pose a great financial burden to the state. As an employer, it is the state's policy to provide comprehensive health care to state employees, officials, their dependents and those who depend upon the state for necessary medical care.

Within the Authority, the Public Employees Benefits Board (PEBB) and the Basic Health Plan (BHP) operate to accomplish this goal. RCW 41.05.055 established the PEBB to design and approve insurance benefit plans for state employees and school district employees. Effective 1993, RCW 70.47.040 placed the BHP within the HCA. The BHP is administered by the HCA and provides a system of enrollment and payment for basic health care services on a prepaid, capitated basis.

### **Territory and Plan of Operation**

The HCA is authorized to provide medical and dental coverage in Washington State and has its principal place of business in Lacey, Washington. The Authority indemnifies and provides the Uniform Medical and Dental Plan to eligible state employees, retirees, political subdivisions, and higher education facilities. In addition to the self-insured medical and dental plans, HCA administers numerous insurance options with several carriers. Certain carriers are organized to deliver or arrange for the delivery of health care services while other carriers provide term life, accidental death and dismemberment and long-term disability insurance.

## Growth of HCA

Year	Assets	Liabilities	Reserves
2001	\$86,286,561	\$57,606,070	\$28,680,491
2002	112,556,853	66,880,130	45,676,723
2003	141,857,826	68,162,405	73,695,421
2004	166,490,174	92,328,980	74,161,194
2005	\$253,220,155	\$113,211,790	\$140,008,365

Year	Revenue	Uniform Medical and Dental Claims	Carrier Payments	Administrative Expenses(1)	Income (Loss)
2001	\$742,842,561	\$262,342,258	\$439,514,144	\$23,580,335	\$17,405,824
2002	827,166,398	297,835,544	488,196,209	24,138,413	16,996,232
2003	934,457,740	332,046,978	555,659,809	24,732,254	22,018,699
2004	1,042,070,832	428,932,482	587,390,322	26,758,989	(1,010,961)
2005	\$1,203,396,365	\$518,517,838	\$589,186,962	\$29,844,394	\$65,847,171

## AFFILIATED ORGANIZATIONS

There are no affiliated organizations.

## MANAGEMENT and CONTROL

The HCA was created within the Executive Branch of the state of Washington under RCW 41.05.021. With the consent of the Senate, the governor appoints an administrator who may employ up to seven exempt staff members and any additional staff members necessary to administer the Authority. The Administrator serving as of June 30, 2005 was Steven R. Hill.

Deputy and Assistant Administrators as of June 30, 2005:

Name	Title
Barney Speight	Deputy Administrator
Mary Fliss	Assistant Administrator PEBB
Janet Peterson	Assistant Administrator UMP
Beth Dupre	Assistant Administrator BH

## **Conflict of Interest**

During the 1994 Legislative Session, RCW Chapter 42.52 – “Ethics in Public Service” was passed, replacing RCW Chapter 42.18 which was in effect during the previous

examination. The new code establishes a single code of ethics that applies to all state officers and state employees in the executive, legislative and judicial branches of government. RCW 42.52.200(1) allows each agency to adopt appropriate rules to protect against violations of this chapter. During 1995, HCA issued Administrative Policy No. 1-14 – “Code of Personal Conduct”, which addresses the personal conduct of all agency employees. No material conflicts of interest were noted in our review. Officers and key employees of HCA are not required to sign conflict of interest Statements. The Director, Steven Hill, has signed a Public Disclosure Statement.

### **Internal Audit Function**

The HCA internal auditor reports directly to the Deputy Administrator, Barney Speight. The internal auditor’s functions are internal audits, external audits of administrative service contracts, and internal policy development.

### **Information Systems (I/S)**

The HCA’s EDP system is administered by the state of Washington’s Human Resources Information Systems Division (HRISD). All responsibility for maintenance and update of the system resides with HRISD. The invoicing system records the receivables, payables, expenses, and accrued revenues and then automatically interfaces with the Automated Financial Reporting System (AFRS) which is the main accounting system for the State of Washington.

The security systems used to control access to user screens resides with the Department of Information Systems (DIS) and HRISD. DIS assigns the security logon and the user selects the password which allows access. HRISD assigns an individual to be Security Administrator for each agency. This individual is then responsible for delegating and maintaining the security level of the individuals within Agency.

The Office of the State Auditor (SAO) conducted an audit of the HCA’s I/S systems for the Fiscal Year 2000. System compliance and controls were tested and the audit report stated that they were in material compliance with the Office of Financial Management (OFM) regulations. No I/S system audit has been performed by the SAO after 2000, since HCA has not changed its I/S system since that time.

### **INCURRED BUT NOT REPORTED RESERVES**

The OIC actuary reviewed the claims unpaid for the fiscal year ending June 30, 2005 for the UMP, HCA’s self-funded program. The review included examining the UMP reserving philosophy and methodologies to determine the reasonableness of liabilities booked in the HCA’s financial statements, and to estimate claims unpaid for the valuation date of June 30, 2005.



The HCA hired Mercer Human Resource Consulting (Mercer) to estimate the unpaid claims. Mercer furnished the OIC with its unpaid claims documentation and calculations, and the paid-incurred data from June 2003 through November 2005.

Mercer determined the amount of claims unpaid as of June 30, 2005 to be \$78,434,161 although the HCA booked a slightly different, but acceptable, balance. Mercer's methodology was one of the methods prescribed by the American Academy of Actuaries and was found to be reasonable.

The OIC estimated the unpaid claims as of June 30, 2005 to be \$69,250,944, as shown below, based on the paid incurred claim data provided by Mercer and using a methodology prescribed by the American Academy of Actuaries:

Valuation Date 06/30/05	Unpaid Claims Estimated by Mercer	OIC Estimate of Unpaid Claims
Non-Medicare Medical	\$61,479,373	\$54,777,855
Non-Medicare Rx	\$1,518,497	\$1,547,949
Medicare Medical	\$9,979,246	\$7,602,514
Medicare Rx	\$855,763	\$844,646
Dental	\$4,601,282	\$4,477,979
Total	\$78,434,161	\$69,250,944

The OIC estimate of total unpaid claims is different from Mercer's estimate. However, no adjustment is recommended, because HCA's booked amount is within a range of reasonable estimates and is therefore acceptable.

### **REINSURANCE**

The Authority is an agency of the state of Washington, which provides its credit rating and financial support to the HCA. Therefore, reinsurance is unnecessary.

### **STATUTORY DEPOSITS**

NONE

### **ACCOUNTING RECORDS AND INFORMATION SYSTEMS (IS)**

The HCA's accounts and records are maintained on a modified accrual basis of accounting which, for OIC reporting purposes, is converted to a modified statutory basis. The HCA uses a subsystem of the HRISD, which interfaces with the state's automated system, AFRS. OFM is responsible for maintaining and designing the AFRS system, which it uses to prepare annual financial statements for the State of Washington in accordance with Generally Accepted Accounting Principles (GAAP). The financial

activities of the Authority are included in the OFM statements, which are audited by the SAO.

Financial Statements filed with the OIC during the examination period were examined and reviewed to verify that they were prepared in a manner consistent with the principles established by the OIC. No material deviations from these standards and procedures were noted other than as noted in the examination Comments and Recommendations.

### **SUBSEQUENT EVENTS**

NONE

### **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

The Authority has taken corrective action with respect to the one instruction made in the 2000 report of examination.

### **FINANCIAL STATEMENTS**

Statement of Assets, Liabilities and Fund Balance  
Statement of Revenue and Expenses  
Reconciliation of Fund Balance for the Period Since the Last Examination

**HEALTH CARE AUTHORITY**  
**STATEMENT OF ASSETS, LIABILITIES AND FUND BALANCE**  
**YEAR ENDED**  
**JUNE 30, 2005**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAMINATION
<b><u>ASSETS</u></b>				
Cash and cash equivalents	\$157,654,423			\$157,654,423
Investments	76,322,494			76,322,494
Interest receivable	109,303			109,303
Premiums due	18,397,273			18,397,273
Other receivables	736,662			736,662
TOTAL ASSETS	<u>253,220,155</u>		<u>\$0</u>	<u>253,220,155</u>
<b><u>LIABILITIES</u></b>				
Accounts Payable - Administration	1,642,176			1,642,176
Accounts Payable - Benefits Providers	32,927,301			32,927,301
Accounts Payable - Deferred Revenue	213,464			213,464
Insured but not reported reserve	78,428,849			78,428,849
TOTAL LIABILITIES	<u>113,211,790</u>		<u>0</u>	<u>113,211,790</u>
<b><u>FUND BALANCE</u></b>				
Beginning of fiscal year fund balance	74,161,194			74,161,194
Current year operations excess (deficit)	65,847,171			65,847,171
TOTAL FUND BALANCE	<u>140,008,365</u>		<u>0</u>	<u>140,008,365</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$253,220,155</u>		<u>\$0</u>	<u>\$253,220,155</u>

**HEALTH CARE AUTHORITY  
STATEMENT OF REVENUE AND EXPENSE  
YEAR ENDED  
JUNE 30, 2005**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAMINATION
<b><u>REVENUE</u></b>				
Insurance Premiums - Self Insured Medical Benefits	\$479,984,882			\$479,984,882
Insurance Premiums - Self Insured Dental Benefits	125,996,032			125,996,032
Insurance Premiums - Other Insured Benefits	593,981,292			593,981,292
Interest and Miscellaneous Income	3,434,159			3,434,159
Total Revenue	<u>1,203,396,365</u>		<u>\$0</u>	<u>1,203,396,365</u>
<b><u>EXPENSES</u></b>				
<b>Insured Benefits and Administration</b>				
Life Premiums	5,945,470			5,945,470
LTD Premiums	3,747,130			3,747,130
Health Premiums	559,864,616			559,864,616
Dental Premiums	19,629,746			19,629,746
Total Insured Expenses	<u>589,186,962</u>		<u>0</u>	<u>589,186,962</u>
<b>Self-Insured Medical Benefits and Administration</b>				
Incurred Medical Claims	436,350,635			436,350,635
Medical Claims Management	12,066,490			12,066,490
UMP Benefits Admin.	2,997,749			2,997,749
Total Self-Insured Medical Expense	<u>451,414,874</u>		<u>0</u>	<u>451,414,874</u>
<b>Self-Insured Dental Benefits and Administration</b>				
Incurred Dental Claims	82,167,203			82,167,203
Dental Claims Management	4,590,306			4,590,306
Total Self-Insured Dental Expenses	<u>86,757,509</u>		<u>0</u>	<u>86,757,509</u>
Risk Adjustment Admin. Expenses	54,950			54,950
Agency Administration	10,134,899			10,134,899
Total Expenses	<u>1,137,549,194</u>		<u>0</u>	<u>1,137,549,194</u>
Excess (Deficit) of Current Year Revenue over Expenses	65,847,171			65,847,171
<b><u>STATEMENT OF FUND BALANCE</u></b>				
Beginning of Fiscal Year Fund Balance	74,161,194			74,161,194
Current Year Excess (Deficit)	65,847,171			65,847,171
End of Period Fund Balance	<u>\$140,008,365</u>		<u>\$0</u>	<u>\$140,008,365</u>

**HEALTH CARE AUTHORITY  
RECONCILIATION OF FUND BALANCE  
FOR THE PERIOD SINCE THE LAST EXAMINATION**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Capital and Surplus, December 31, Previous	\$74,161,194	\$73,695,421	\$45,676,723	\$28,680,491	\$11,274,667
Current Year Excess (Deficit)	65,847,171	(1,010,961)	22,018,698	16,996,232	17,405,824
Contributed Capital			6,000,000		
UMP Pharmacy Settlement		1,476,734			
Net change in capital and surplus for the year	65,847,171	465,773	28,018,698	16,996,232	17,405,824
Fund Balance	<u>\$140,008,365</u>	<u>\$74,161,194</u>	<u>\$73,695,421</u>	<u>\$45,676,723</u>	<u>\$28,680,491</u>

## **NOTES TO THE FINANCIAL STATEMENTS**

1. The Authority is permitted to file its financial statements with the state of Washington on a modified statutory basis determined in conjunction with the OIC.

### ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Authority during the examination are hereby acknowledged.

In addition to the undersigned, Lichiou Lee, ASA, MAAA; Richard Bologna, Certified Fraud Examiner; Juanita Marrero, CPA; John Gaynard, CFE, CPA, FLMI; and Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Constantine Arustamian, CFE, CPA

Examiner-in-Charge

Washington State Office of the Insurance Commissioner

Constantine Arustamian

Constantine Arustamian, CFE, CPA

Examiner-in-Charge

State of Washington

Subscribed and sworn to before me on this 25th day of July, 2006.

Colleen Jansen

Notary Public in and for the  
State of Washington

